HOUSING MARKET ASSESSMENT

Montréal CMA

Date Released: Second Quarter 2018

Canada

CMHC SCHL

Highlights

Results Overview
Montréal CMA

	Jan. 2018	Apr. 2018
Overheating		
Price Acceleration		
Overvaluation		
Overbuilding		
Overall Assessment		

Degree of vulnerability
■ High ■ Moderate ■ Low

- According to the Housing Market Assessment (HMA) analytical framework, the degree of vulnerability of the Montréal census metropolitan area (CMA) housing market remained low during the fourth quarter of 2017.[1]
- Evidence of overvaluation remained weak, owing to house prices that remained in line with economic and demographic fundamentals.
- Evidence of both overheating and acceleration in the growth of house prices remained weak. However, the Montréal resale market continued to tighten, and this maintained upward pressure on prices.
- Evidence of overbuilding remained weak, as the number of completed and unsold homes per 10,000 population, as well as the rental vacancy rate, both remained well below their problematic thresholds.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's market analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects problematic market conditions in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates on account of supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance. Colour codes indicate the level of evidence of problematic conditions.

The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average) and the persistence over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

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[1] Results are based on data as of the end of December 2017 and local market intelligence up to end of March 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

In Detail

Evidence of overheating remained weak; still, tightening conditions were observed

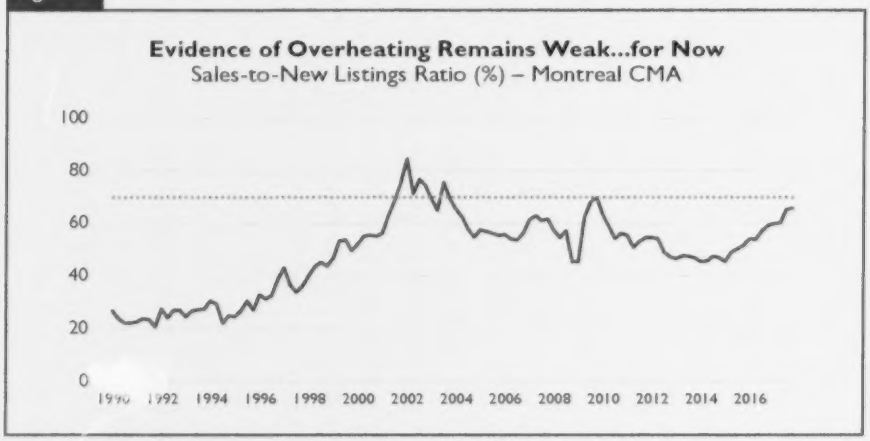
During the fourth quarter of 2017, evidence of overheating on the resale market remained weak. Indeed, the seasonally adjusted sales-to-new listings ratio was close to 66% (see figure 1), which is below the problematic threshold.[3] Still, the ratio increased for a sixth straight quarter, as Centris® sales increased more rapidly than new listings. As such, the ratio moved closer to the threshold for overheating, and this maintained significant pressure on prices.

For its part, the active listings-to-sales ratio,[4] another market indicator, decreased significantly. While, only two quarters before, it still reflected a balanced Montréal resale market, in the fourth quarter of 2017, it had decreased to the point where it signalled a resale market that was, overall, favourable to sellers.[5] Market characteristics did differ from one segment to another, however (see figure 2). The single-family home and plex segments were in sellers' market territory.[6] The condominium segment, meanwhile, was balanced across the CMA, but, if it continues along its current trend, will likely cross over to being a sellers' market in the next few months. Over the next few quarters, we expect market conditions to continue to tighten, as sales should maintain their upward trend, while active listings should continue to decrease.

Lukas Jasmin-Tucci
Senior Analyst

"For a fifth straight quarter, the degree of vulnerability of the Montréal CMA housing market has remained low. The strength of the fundamentals supported the price levels observed. However, the Montréal resale market continued to tighten, and this increased pressure on prices."

Figure 1



Source: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC. Last data point: 2017 Q4.

Figure 2

Source: QFREB by the Centris® system, seasonally adjusted data by CMHC (three-month moving average). Last Data point: December 2017

[3] This threshold is set at 70%.

[4] While the sales-to-new listings ratio tells us about sales in relation to the pace of new listings on the resale market, the active listings-to-sales ratio provides information on the status of inventories relative to the rate of sales.

[5] In a sellers' market, the ratio is less than 8 sellers (in other words, active listings) for each buyer (in other words, Centris® sale). In a balanced market, the ratio is between 8 and 10, and, in a buyers' market, it is higher than 10 sellers for each buyer.

[6] In a sellers' market, sellers have greater negotiating power relative to buyers, and there is usually higher pressure on prices.

As for single-family homes, the active listings-to-sales ratio decreased in all of the large sectors[7] of the metropolitan area, and the market was even more favourable to sellers than it had been in the previous quarter[8]. This was particularly evident in certain sectors of the Island of Montréal, where there were as few as four sellers (sometimes even fewer) for each buyer. The West Island, Le Sud-Ouest, Rosemont and Île-des-Sœurs are all examples of sectors where this was the case.

In the condominium segment, while the market continued to tighten and the active listings-to-sales ratio decreased in all large sectors of the CMA, conditions remained favourable to buyers in three of the five sectors. This was not the case, however, in Vaudreuil-Soulanges, where conditions were on the fence between a balanced and a buyers' market, or on the Island of Montréal, where the market was balanced. Several of the Island's central sub-sectors, such as Le Sud-Ouest, Verdun, Westmount, Le Plateau-Mont-Royal and Rosemont, stood out, with ratios of fewer than seven sellers per buyer.

Laval and the North Shore continued to post the highest ratios, at about 13 sellers per buyer. Evidently, condominium supply remained higher in the North Crown.

Evidence of price growth acceleration was weak, but continues to be monitored

Evidence of acceleration in the growth of house prices was weak in the fourth quarter of 2017. Still, the tightening of the resale market over the fourth quarter maintained pressure on prices.

From October to December 2017, the average Centris® price rose by 6.7%, a slightly sharper increase than the 5% to 6% (or thereabouts) recorded over the previous quarters.

We should point out, though, that other price indicators, such as the median price, suggest a more "up and down" trend over the last year. Take the median price of single-family homes, for instance, which showed quarterly growth rates of 5.1%, 7.5%, 6.0% and 5.0% (from the first to the last quarter) in 2017. As such, before making any categorical assertions about the presence or absence of price growth acceleration on the Montréal housing market, it would be important to see how these other indicators behave in comparison to the average price.

While evidence of price growth acceleration remained weak, overall, across the Montréal area in the fourth quarter of 2017, certain sectors[9] on the Island of Montréal did stand out, with growth in the average price of single-family homes reaching 15% to 25%,[10] which is generally higher than it was at the same time the previous year.

The condominium segment, which, after a long period of easing, was approaching sellers' market conditions, recorded a steady increase in the average price in the fourth quarter of 2017 in most of the sectors of Greater Montréal. Again, the Island of Montréal stood out, with an increase in the average price of 11% during the fourth quarter, far higher than the 3% recorded one year earlier.

Over the next few quarters, the economic outlook should remain favourable to housing demand, and the market should continue to tighten. Given the recent evolution of prices on the Montréal resale market, the classification of the price growth acceleration indicator could change over the next few months.

Evidence of overvaluation remained weak

In the fourth quarter of 2017, the growth in economic and demographic fundamentals continued to support the price levels observed on the Montréal housing market. As a result, the HMA continued to detect weak evidence of overvaluation. This means that the model did not identify any significant imbalance between real house prices and the price level dictated by housing market fundamentals, such as personal disposable income and population.

A more detailed analysis reveals that most fundamentals were stronger in the fourth quarter of 2017 than in the fourth quarter of 2016. The population continued to grow (+1.3%), the real five-year fixed

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[7] Island of Montréal, Laval, North Shore, South Shore and Vaudreuil-Soulanges.

[8] Since the second quarter of 2015, single-family home market conditions have been tightening at similar rates in all sectors of the CMA. However, on the Island of Montréal and the South Shore, conditions were tighter to begin with than in Laval, on the North Shore or in Vaudreuil-Soulanges.

[9] Notre-Dame-de-Grâce, Montréal-Ouest, the southern portion of the western part of the Island, and the boroughs of Le Sud-Ouest, St-Laurent and Ahuntsic-Cartierville.

[10] Change compared to the fourth quarter of 2016. Actual, unadjusted data.

mortgage rate[11] decreased (from 3.2% to 1.6%) and real personal disposable income per capita increased (+1.4%).

As for real house prices (adjusted for inflation), they showed mixed results. On the one hand, Statistics Canada's New Housing Price Index (NHPI)[12] fell by 0.3% relative to the fourth quarter of 2016. On the other hand, the average Centris® price[13] and the Teranet–National Bank House Price Index™ rose by 5.0% and 3.4%, respectively.

Since 2016, economic conditions in the Montréal area have remained favourable to housing demand. That is to say that, even though prices increased, they did so in a context of improving fundamentals.[14] Reflecting this, the overvaluation analysis showed little difference between real house prices and the prices dictated by the fundamentals.

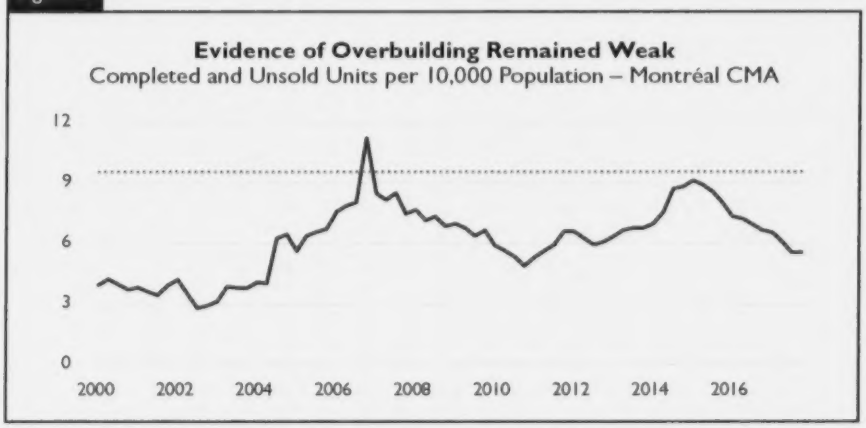
Evidence of overbuilding remained weak

In the fourth quarter of 2017, both overbuilding indicators (the number of completed and unsold homes per 10,000 population, and the vacancy rate for conventional rental units) suggested weak evidence of overbuilding (see figures 3 and 4).

From October to December 2017, the number of completed and unsold homes per 10,000 population remained low, at 5.5 (the same level as the previous quarter). As such, it remained under the threshold[15] that would indicate an imbalance in homebuilding in Montréal. In fact, this was the lowest level this indicator had reached in the metropolitan area since the beginning of 2011. The increase in demand, combined with the marked slowdown in condominium starts over the last two years,[16] allowed the inventory of unsold new condominiums to remain relatively low.

However, the strength of construction activity over the last four months of 2017 led to a 40% increase in condominium starts (annualized growth rate). This will result in an increase in completions, and will likely put upward pressure on the inventory of unsold new

Figure 3



Sources: Statistics Canada and CMHC. Last data point: 2017 Q4.

Figure 4

Source: CMHC. Last data point: October 2017

[11] Average negotiated rate adjusted for inflation.

[12] Source: Statistics Canada.

[13] Source: Quebec Federation of Real Estate Boards, through the Centris® system.

[14] The presence of foreign buyers in the Montréal CMA does not seem to be a determining factor in the price increase, since it is limited overall.

[15] This threshold is 9.5.

[16] Condominium starts decreased by 25% in 2015 and by 14% in 2016.

condominiums over the next few quarters, without, however, pushing it past the problematic threshold in the short term.

The vacancy rate for conventional rental units, for its part, decreased. According to the Rental Market Survey, it fell from 3.9% in October 2016 to 2.8% in October 2017. The reason for the decline: an increase in conventional rental demand driven by an upswing in net migration. Indeed, net international migration rose sharply in the Montréal area, particularly in the category of non-permanent residents, while the interprovincial migration deficit decreased slightly.[17]

These factors caused rental demand to increase[18] at a faster pace than supply between the 2016 and 2017 surveys. Still, with strong rental apartment construction activity currently occurring in Greater Montréal, we will have to wait and see if the vast majority of these new units find tenants in the next few quarters. If not, the result would be upward pressure on the vacancy rate. Still, the vacancy rate would remain below the threshold that would signal evidence of overbuilding on the Montréal housing market.

[17] Net international and interprovincial migration in the province increased by about 9,000 people from July 2016 to June 2017. The Montréal CMA generally receives about 60% of this gain.

[18] Census data from 2011 shows that migrants tend to opt for rental accommodations when they arrive in a new area. The large number of migrants who arrived in the Montréal area therefore likely contributed significantly to strengthening rental demand.

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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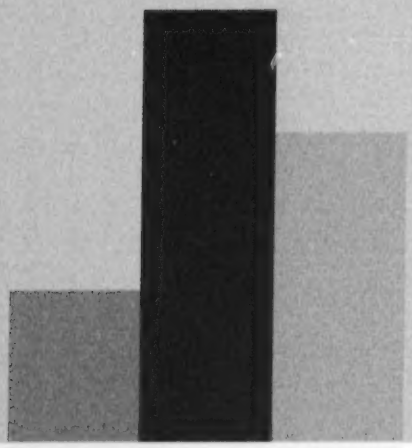

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